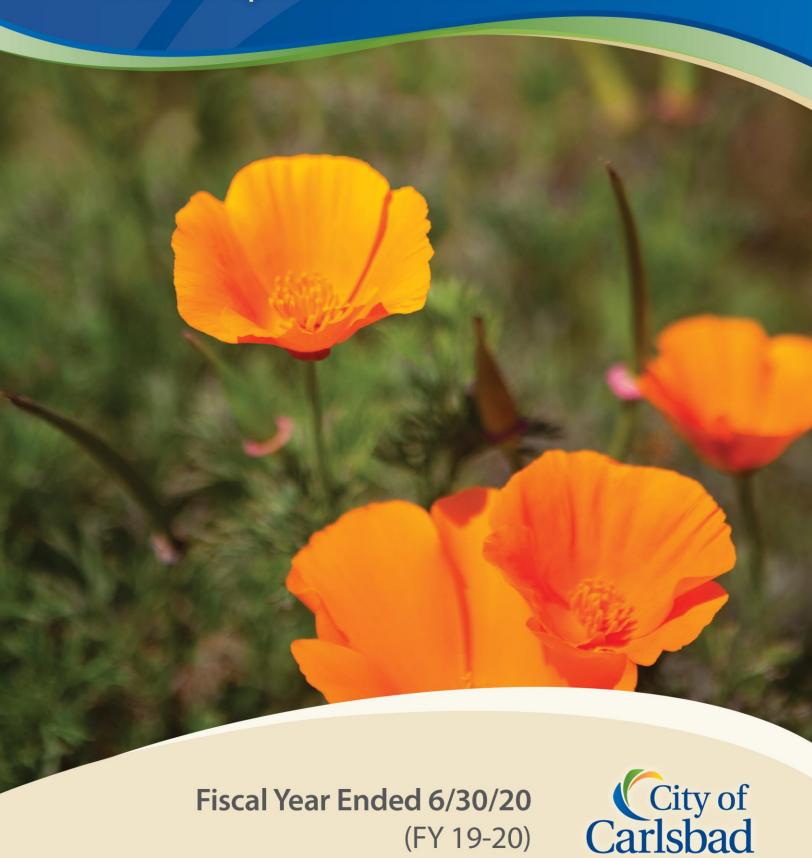
City Treasurer's Annual Report of Investments





CITY | REPORT OF | INVESTMENTS

Fiscal Year Ended June 30, 2020

Prepared by
Craig Lindholm, City Treasurer
February 16, 2021





TABLE OF CONTENTS

Letter of Transmittal

Annual Report of Investment Portfolio

Fiscal Year 2018-19 Market Review

Portfolio Analysis

Fiscal Year 2018-19 Review

Appendices to Annual Report of Investment Portfolio

Appendix A: Risk Management

Appendix B: Disclosures

Appendix C: Portfolio Activities





CITY TREASURER LETTER OF TRANSMITTAL

Fiscal Year 2019-20 Annual Report of Investment Portfolio

February 16, 2021

Honorable Mayor, City Council and residents of the City of Carlsbad,

I am pleased to present the Annual Report of Investments for the City of Carlsbad for the fiscal year 2019-20 which ended June 30, 2020. The report is intended to provide reliable information as a basis for reviewing portfolio performance and making management decisions. It also provides an archival reference.

The city treasurer is charged with the design of an effective cash management and investment program for the City of Carlsbad and all its agencies. Among other activities, this includes arranging banking services; forecasting all cash receipts and expenditures; investing all inactive cash; managing investment risk exposures; and reporting all investment activities.

This report summarizes and analyzes the activities of the investment portfolio over fiscal year 2019-20. Total portfolio assets, investment portfolio relative to total city assets, source of portfolio assets, asset allocations, yield achieved, unrealized gains and losses, and cash revenues are presented. To provide perspective to this data a summary of observations is provided about global and domestic markets for the fiscal year ended June 30, 2020. Comparisons are also made with the preceding fiscal years. Finally, a statement is offered regarding the prospects for the fiscal year 2020-21.

Sincerely, Cray J. Frillel

Craig J. Lindholm,

City Treasurer



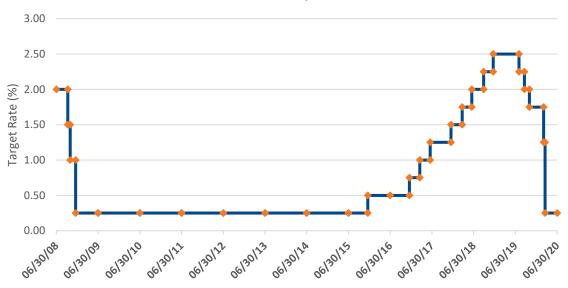


FISCAL YEAR 2019-20 MARKET REVIEW

Federal Funds Target Rate

The federal funds rate is a key money market rate that correlates with rates of other short-term credit arrangements. It is the interest rate that banks charge each other for overnight loans. In fiscal year 2019-20, the Federal Reserve ultimately decreased the federal funds by 1.75%.

Federal Funds Target Rate History



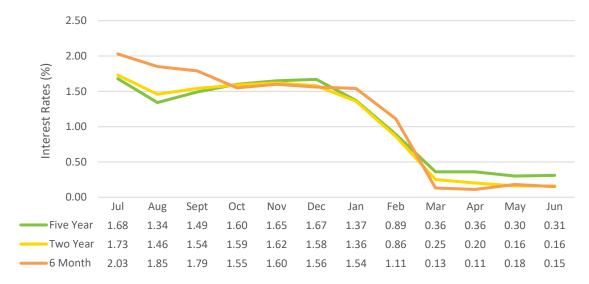


Short-Term Interest Rates

Changes in short-term market interest rates are usually affected by the actions of the Federal Reserve.

Short-term interest rates in the five year, two year, and six month markets decreased in fiscal year 2019-20.

Short-Term Investment Rates
US Treasury Instruments
Fiscal Year 2019-20

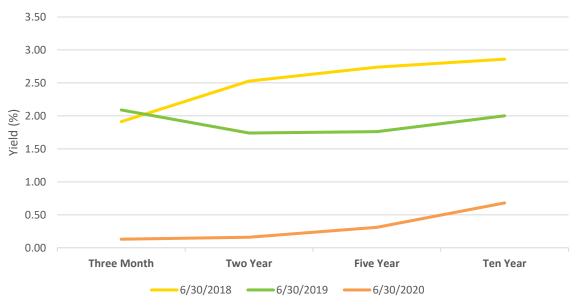




Market Yield Curve

The yield curve is a graphic presentation of the difference between short-term and longer-term interest rates of US Treasury instruments on a given day. Financial analysts use it to assess the market's expectation of recession or inflation. The normal shape of the yield curve mostly flat with a small upward slope, with short-term rates lower than longer-term rates. A normal yield curve occurs when short-term market rates are less than longer-term market rates. Normal yield curves point toward economic expansion.

Market Yield Curve Three Year History





PORTFOLIO ANALYSIS

Portfolio Assets

Total assets in the investment portfolio, based on book value, stood at \$812.8 million at the end of the fiscal year; a \$19 million increase. This increase includes interest earned, loan payments received, and revenues in excess of expenses.

Investment Portfolio Total Book Value of Assets



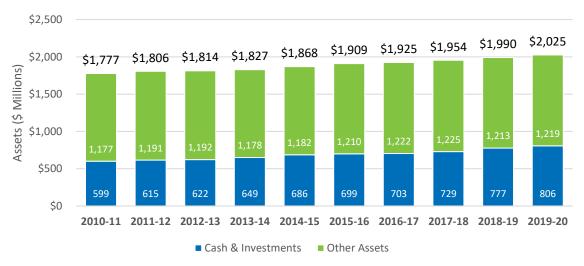


Total City Assets

The city publishes a *Comprehensive Annual Financial Report (CAFR)* at the end of each fiscal year as required by California state law and in conformity with General Accepted Accounting Principles and requirements prescribed by the Governmental Accounting Standards Board.

Among other information, the *CAFR* presents a statement of net position showing the total assets owned by the city and all its agencies. At the end of fiscal year 2019-20, cash and investments managed by the city treasurer represented 39.8% of all assets reported by the city and its agencies.

Cash & Investments Relative to Total Assets Fair Market Value

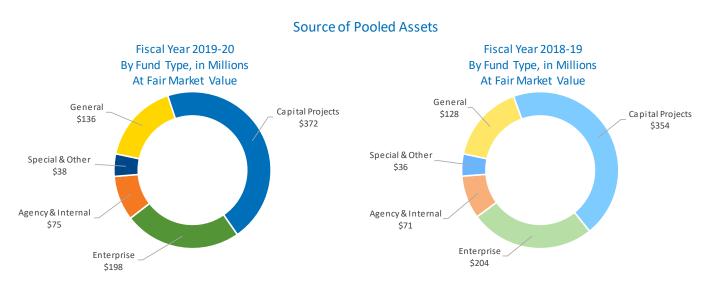




Sources of Assets

The portfolio is an internal investment pool that invests the available cash from various funds of all city agencies, city owned and fiduciary assets. The top three sources of portfolio assets calculated at market value are: Capital Project Funds at 44.7%; Enterprise Funds at 24.2%; and the General Fund at 16.7%. Together, these three funds account for 85.6% of total portfolio assets.

The Capital Project Fund includes funds for the General Capital Construction, Traffic Impact Fees, Public Facilities Fees, Park Development, TransNet Taxes, Drainage Fees, Special Districts, Infrastructure Replacement, and Gas Tax funds. Enterprise Funds are the Carlsbad Municipal Water District, Sewer, Solid Waste, Storm Water, and Golf Course funds.

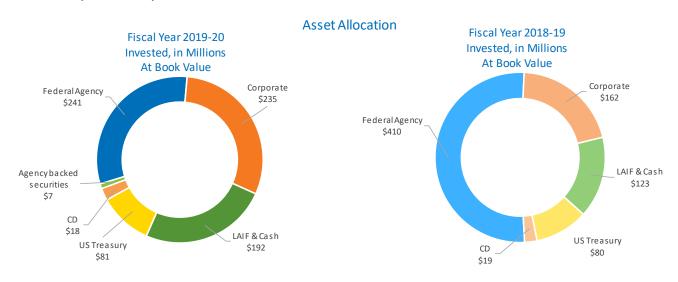




Allocation of Assets

Investments are made in financial instruments as authorized by the City of Carlsbad Investment Policy and the California Government Code. With the exception of bank deposits and deposits in the California state Local Agency Investment Fund (LAIF), all investments are in fixed-income instruments with known maturity dates.

On June 30, 2020, 29.6% of portfolio assets were invested in federal agencies, 28.5% in corporate notes, 10.0% in US Treasuries, 2.3% in certificates of deposit and 23.8% in cash and cash equivelents. During the past fiscal year, the dollar allocation of portfolio assets to federal agencies, corporate notes, LAIF, cash, and certificates of deposit increased while the allocation to US Treasuries decreased from the previous year.



Federal Agency Breakdown by Percentage of Total Portfolio

Federal Farm Credit Bank	12.28%	Federal Agricultural Mortgage Corporation	1.98%
Federal Home Loan Bank	9.70%	Tennessee Valley Authority	0.49%
Federal Home Loan Mortgage Corporation	9.41%	RFCO Strip Principal	0.49%
Supranational	6.45%	Private Export Funding Corporation	0.41%
Federal National Mortgage Association	4.13%		

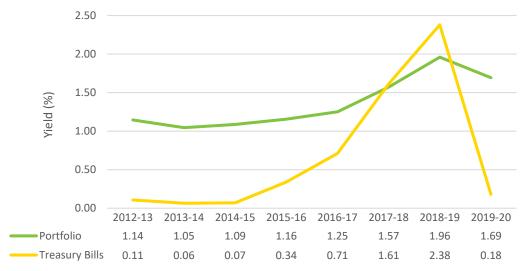


Yields

The average return of the portfolio decreased from 1.96% to 1.69%. The portfolio yield is heavily influenced by changes in short-term market interest rates. The average interest rate for six-month US Treasury Bills decreased to 0.18% from 2.38% the previous year. This graph shows the change in percentage of the portfolio over the last several years. Investments gain and lose market value subsequent to purchase because of changes in market interest rates. When market interest rates decrease, investments made previously at higher rates will gain value. The reverse is true when market interest rates increase. Accountants refer to these changes in value as unrealized gains and unrealized losses (commonly referred to as paper gains and paper losses). The gain/loss is not recognized until the investment is sold. Changes in value due to changes in market interest rates are normal and are to be expected.

With a buy and hold policy, an objective of the city's investment policy is to achieve an average market rate of return over the economic cycle.

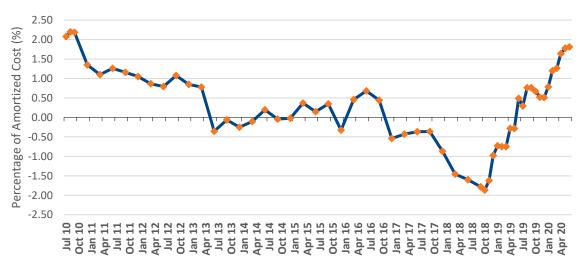






The success in achieving this objective can be approximated with having unrealized gains and losses that are relatively equal over time. Tracking and measuring unrealized gains and losses could also reveal any presence of high-risk investments in the portfolio. The changes in asset values shown in the graph indicate portfolio investments are within acceptable interest rate risk standards identified in the city's investment policy. The total portfolio had an unrealized gain of 1.812% on June 30, 2020. If going forward, we begin to see moderation occur, with respect to future interest rate increases, unrealized gains and losses should remain at or near zero percent. This is due to the average maturity of the overall portfolio positioned at just under two years.

Historical Unrealized Gains & Losses





Annuity Stream

Interest income from portfolio investments represents an annual stream of revenues. This annual stream totaled \$17.03 million, an increase of \$2.19 million from the previous fiscal year. This increase can be attributed to early higher yields earned by the portfolio prior to the Covid-19 pandemic and an overall larger pool of investments. Of the total cash interest revenues earned by the portfolio, approximately \$3.4 million was credited to the General Fund. Cash income is a function of assets in the portfolio, the market interest rates at the time of the investments, and interest payment schedules of the portfolio holdings.

Annuity Stream From Treasury Cash Interest Revenue





FISCAL YEAR 2019-20 REVIEW

Global & Domestic Observations

Whatever projections were originally made for 2020 have been increasingly revised downward. As of June 2020 global economic growth was projected to come in at 5.4%. This represents a reduction of 6.5% from earlier projections in January of 2020. The relentless spread of Covid-19 has changed everything. As businesses weave their response to this pandemic, they face multiple headwinds. Immediate investments have been concentrated in workplace protection construction, personal safety devices, masks, and physical shielding. Retail spaces have been reconfigured with reduced capacity and restaurants have experienced significant cuts to their dining seating. Restaurants have been especially impacted by tough Covid-19 guidelines. This environment, in certain markets, has resulted in the closure of 40% of small businesses. On the consumer side, globally and domestically, lockdowns have resulted in reduced demand for goods and services. Savings rates for those still working have soared due to concern over the potential elimination of their employment. One projection estimated that between the last quarter of 2019 and the first quarter of 2020 lost hours of work were the equivalent of 180 million jobs. The decisions to inject fiscal stimulus and other forms of benefits and support by governments around the world have helped mitigate the damage to households and individuals throughout the pandemic. The result of this financial support and accommodative fiscal policies has created huge deficits around the world. Several estimates project these expenditures at just under \$13 trillion. Energy costs in the fossil fuels sector hit historically low levels, especially in April of 2020. Since that low, oil has traded in a stable range helping to keep inflation in check.



Another global development is the growing interest in and acceptance of cryptocurrencies. Bitcoin is the largest cryptocurrency at this time. Financial institutions and individuals are seeking alternative investments as defensive strategies in the face of weakening currencies. While still far from mainstream, interest in these new forms of currency is strengthening. As a point of comparison, the US dollar represents 62% of the worlds reserve currency. We receive numerous benefits from our currency holding this acknowledgment of being the world's largest reserve currency.

As of June 30, 2020, there were 10.2 million cases of Covid-19 confirmed with more than 500,000 reported deaths worldwide. It was noted at the time that the pandemic was speeding up. As a result of these grim statistics, economic forecasts were being revised everywhere, placing extraordinary pressure on corporate leadership and governments everywhere to revise their approach. Multiple approaches to potential vaccines were launched. As of June 2020, roughly 20 million Americans had lost their jobs.

One of the many changes that the American workforce faced as the pandemic spread across the United States was the shift to work from home. To further complicate matters, K through 12 students found themselves thrust into a remote learning environment with parents assuming responsibility of their child and their participation in this grand experiment. Colleges and universities were already trending into remote learning options, the pandemic only helped accelerate the shift distance learning.



Corporations with large corporate offices suddenly found themselves with significant excess office space. Minimal staffing for required support functions continue to work in their traditional environment. The majority however, found that working from home was a plus, giving time and providing greater family connections if they could make it work. Employee productivity was an initial concern, but as the pandemic has progressed most businesses are reporting satisfactory results. Many businesses have identified new protocols to their existing business model that are a direct result of this new environment. Customer service is being reinvented on a daily basis as businesses look for ways to protect their employees and customers as everyone adapts to this "new normal".

Another economic impact has been trending in the housing market. Extended periods of lockdown have identified needs for more space for work at home families and a desire to have a yard to enjoy the outdoors. This has sparked a trend termed deurbanization. The appeal of living in a downtown city space seems to be fading as the ability to work remotely has opened up the option of living elsewhere. This coupled with a shortage of new and existing housing inventory has pushed up housing prices to historically high levels. In addition to the lack of inventory, the Federal Reserve's 0% highly accommodative interest rate policy has moved mortgage financing rates to all-time lows, putting further pressure on housing prices.

Financial returns in the period ending June 30, 2020 were surprisingly positive. There was a strong rebound from the March 2020 lows, primarily in response to the huge infusion of fiscal and monetary stimulus provided by the federal government to prop up the economy as the impact of the pandemic affects more businesses and individuals throughout the economy. Technology stocks have been the primary leaders during this period.



At the end of fiscal year 2019-20, LAIF investments had a yield of 1.15%, and all other investments had a yield of 1.88%. Revenues from the investment portfolio are projected to decrease over the coming year due to the effects that the Covid-19 pandemic has had on yields.

For the month of June 2020, the yield of the total portfolio averaged 1.69%. Total assets in the investment portfolio stood at \$828 million as measured at fair market value at the close of fiscal year 2019-20.





CITY TREASURER ANNUAL REPORT OF INVESTEMENTS

APPENDICES





APPENDIX A: RISK MANAGEMENT

Risk Management

All investments are exposed to risk of some type. The objective of risk management is to identify the risks involved and establish acceptable levels of risks that are consistent with the city's investment objectives. Risk management includes managing, measuring, monitoring, and reporting the various risks to which portfolio investments are exposed.

Portfolio investments are exposed to the following types of risks:

- Credit risk
 - Custodial credit risk
 - Investments
 - Deposits
 - Default credit risk
 - Concentration credit risk
- Interest rate risk
- Event risk

As of June 30, 2020, the portfolio had the following investments and cash in its internal investment pool. The amounts shows do not include \$3.5 million in interest receivable.

Investment	Maturities	Market Value	Gain (Loss)*
US agencies	July 2020 – June 2025	\$ 368,065,333	\$ 130,577,062
Agency-backed MBS	November 2022 – May 2025	7,227,112	61,217
Corporate notes	July 2020 – June 2025	240,987,959	6,851,312
Certificates of deposit	July 2020 – June 2025	18,956,503	626,362
CAMP		1,004,415	-
LAIF		185,227,581	-
Cash accounts		 6,857,307	
		\$ 828,326,210	\$ 138,115,953

^{*}Market value less amortized cost.



APPENDIX B: DISCLOSURES

Custodial Credit Risk (Investments)

The city uses a third-party custody and safekeeping service for its investment securities. Wells Fargo Bank is under contract to provide these custodial services. Custodial credit risk is the risk that the city will not be able to recover the value of its investments in the event of a Wells Fargo Bank failure. All city investments held in custody and safekeeping by Wells Fargo Bank are held in the name of the city and are segregated from securities owned by the bank. This is the lowest level of custodial credit risk exposure.

Custodial Credit Risk (Deposits)

The city maintains cash accounts at Wells Fargo Bank. At the conclusion of each business day, balances in these accounts are "swept" into overnight investments. These overnight investments are pooled and collateralized with either US government securities or US agency securities. The California Code authorizes this type of investment. A small amount of cash is not swept from the Wells Fargo Bank checking accounts to cover checks that may be presented for payment. Amounts up to \$250,000 are FDIC insured.

Default Credit Risk

Default credit risk is the risk that the issuer of the security does not pay either the interest or the principal when due. The debts of most US agencies are not backed by the full faith and credit of the federal government; however, because the agencies are US Government-sponsored, they carry double A (AA) credit ratings. The default credit risk of these investments is minimal.

Unless otherwise exempted, California Government Code limits investments to the top three credit ratings: AAA, AA, and A. It is the city's policy, however, to limit investments to the top two

credit ratings (AAA and AA). As of June 30, 2020, five investments in corporate notes had a credit rating below the AA limit. These investments were made when the credit ratings were either AAA or AA and a subsequent change in rating has occured. California Government Code and the city's investment policy allow the city treasurer to determine the course of action to correct exceptions to the policy. It is the intent of the city treasurer to hold these investments in the portfolio until maturity unless events indicate a sale should be made.

The default credit risk for corporate notes with a credit rating of single A (A) is considered by the city treasurer to be within acceptable limits for purposes of holding to maturity and is within the California Government Code limitations.

LAIF is an investment pool managed by the California state treasurer. Its investments are short-term and follow the investment requirements of the state. As of June 30, 2020, the average maturity of the LAIF investments was 180 days. The state treasurer is not required to contract for a credit rating to be assessed for LAIF. California Government Code Section 16429.3 excludes LAIF deposits from being transferred, loaned, impounded or seized by any state agency or official.

Concentration Credit Risk

Concentration credit risk is the heightened risk of potential loss when investments are concentrated in one issuer. The California Government Code does not identify a specific percentage that indicates when concentration risk is present for any one issuer. California Government Code Section 53601(k) does, however, require that total investments in medium-term corporate notes of all issuers not exceed 30% of the portfolio. As of June 30, 2020, approximately 28.5% of the city's total portfolio investments were in medium-term corporate notes.



For concentration of investments in any one issuer, the city's investment policy requires that no more than 5% of investments in corporate notes be in any one issuer. There is no similar requirement in either the California Government Code or the city's investment policy for US agencies. As of June 30, 2020, no investments in any one corporate issuer exceeded 5% of total portfolio investments.

Interest Rate Risk

Interest rate risk is the risk that investments will lose market value because of increases in market interest rates. A rise in market interest rates will cause the market value of investments made earlier at lower interest rates to lose value. The reverse will cause a gain in market value. As of June 30, 2020, the portfolio had a 1.81% gain in market value based on cost.

The city's investment policy has adopted two means of limiting its exposure to market value losses caused by rising market interest rates: (1) limiting total portfolio investments to a maximum modified duration of 2.2, and (2) requiring maturing investments within one year to be equal to an amount that is not less than two thirds of the current year operating budget of \$297,048,458 (fiscal year 2019-20). As of June 30, 2020, the modified duration of the portfolio was 1.77, within the required maximum of 2.2. Investments maturing within one year were \$313,065,467, exceeding the required minimum of \$297,048,458. The city's exposure to interest rate risk is within acceptable limits.

Event Risk

Event risks include the chance that something unexpected will impede the ability of an issuer of a security to meet its obligations. These types of risks are usually short in duration, but can impair the city's ability to communicate with or use banking services. Such an event could cause a delay in collecting securities which have matured. Security risks are also within this category.

APPENDIX C: PORTFOLIO ACTIVITIES - FISCAL YEAR 2019-20

The city's portfolio balance increased 2.4% from \$793.8 million to \$812.8 million based on book value in fiscal year 2019-20. The increase of \$19 million does little to show the volume of cash that flows in and out of the portfolio during one fiscal year. The following table illustrates that the city treasurer managed \$1.6 billion of cash inflows and cash outflows which prompted investment decisions during fiscal year.

Cash Inflows and Outflows

Bond calls	\$	200,000,000
Bond maturities		149,000,000
Bond purchases		291,000,000
Interest income		1,700,000
LAIF investments		305,300,000
LAIF withdrawals		237,600,000
Sweep investments		213,200,000
Sweep withdrawals		223,600,000
	\$:	1,621,400,000

